

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)	
)	
GEORGE AND LINDA BARRY,)	Nos. 91A-1048-CD
DEWITT W. AND PATRICIA A. CLINTON,)	91A-0928-CD
RICHARD AND DIANA HIRSH, AND)	91A-1163-CD
ROBERT K. LEVIN)	91A-1036-CD

For Appellants: George and Linda Barry

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Avram Salkin, Attorney at Law

For Respondent:

Paul J. Petrozzi, Counsel
Karen Smith, Counsel
Edward J. Kline, Counsel
A. Jovanovich, Counsel

OPINION

These appeals are made pursuant to section 18593^{1/} of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of George and Linda Barry, DeWitt W. and Patricia A. Clinton, Richard and Diana Hirsh, and Robert K. Levin against proposed assessments of additional personal income tax in the amounts of \$16,547.22, \$18,488.53, \$177,486.60, and \$178,997.69, respectively, for the year 1986.

^{1/} Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

The issues in these appeals^{2/} are: (1) whether the unrecognized portion of capital gain from the sale of small business stock that was acquired before September 17, 1981, is excludable from preference income under former section 17063.11,^{3/} and (2) whether appellants have the burden of proving that stock which they sold qualified as "small business stock" under subdivisions (e) and/or (f) of former Revenue and Taxation Code section 18162.5 even though respondent raised this issue for the first time on appeal. We have previously resolved the first issue against respondent in the Appeal of Magnus F. and Denise Hagen, decided April 9, 1986, and more recently in the Appeal of Brian L. and Phyllis Harvey, decided April 23, 1992. Because we see no need to revisit this issue or any related issue resolved in those appeals, we shall consider only the second issue in this matter.

The respective appellants acquired their stock under consideration here on various dates before September 17, 1982. When appellants later sold their stock, they apparently relied on this board's decision in Hagen and excluded from preference income under former section 17063.11 the unrecognized portions of capital gain from the sales of stock that they considered small business stock. Although this board held in Hagen that the exclusion from preference income provided by former section 17063.11 for small business stock was applicable regardless of the date of acquisition of the small business stock, respondent determined on audit that the unrecognized portions of appellants' capital gains should not have been excluded from preference income because their stock was acquired before September 17, 1981, and, as a result, the benefits of that section were not available to them.

After making these determinations, respondent informed appellants that it was seeking to overturn in various courts the rule announced by this board in Hagen and requested appellants to waive the statute of limitations with regard to assessments so that respondent could then issue assessments if its position ultimately prevailed in court. When appellants declined to make the requested waivers, respondent issued Notices of Proposed Assessment in which respondent indicated that the preference tax exclusions were incorrectly claimed because appellants' stock had not been acquired after September 16, 1981. After respondent affirmed its assessments, these timely appeals followed.

On appeal, respondent contends for the first time that appellants should not prevail, even if Hagen remains good law, because they have not carried what respondent argues is their burden of proving that their stock constituted small business stock for purposes of the applicable subdivisions of

^{2/} The Appeal of George and Linda Barry, Appeal of DeWitt W. and Patricia A. Clinton, Appeal of Richard and Diana Hirsh, and Appeal of Robert K. Levin have been consolidated because of the essential identity of the legal issues and relevant facts in these appeals.

^{3/} The Clinton appellants raise the additional issue of whether they are entitled to reimbursement under the Taxpayers' Bill of Rights for their fees and expenses resulting from respondent's allegedly unreasonable action in their appeal. However, Revenue and Taxation Code section 21013, subdivision (a)(1), makes clear that it is premature for the board to consider this issue because the Clintons have not yet filed a claim with the State Board of Control for fees and expenses.

former section 18162.5.^{4/} In response, appellants argue that the burden of proof with regard to the small business stock status of their stock has shifted to respondent because respondent has raised this issue for the first time on appeal. They contend that they should prevail with regard to the issue of the small business stock status of their stock because respondent has not presented adequate proof that their stock was not small business stock at the pertinent times. We disagree with respondent's contention and agree with that of appellants.

This board has held that if respondent's position on appeal alters the original deficiency asserted against the taxpayer or requires the presentation of different evidence, then a "new matter" has been introduced and the burden of proving its new position shifts to respondent. (Appeal of David G. and Helen Mendelsohn, Cal. St. Bd. of Equal., Nov. 6, 1985 (citing Achiro v. Commissioner, 77 T.C. 881 (1981)).) The rule that we stated in Mendelsohn applies as well to the instant appeals, and therefore we must determine whether the issue of the small business stock status of appellants' stock

^{4/} For 1986, subdivisions (e) and (f) of former section 18162.5 read as follows:

(e) For purposes of this section, "small business stock" is an equity security issued by a corporation which has the following characteristics at the time of acquisition by the taxpayer:

(1) The commercial domicile or primary place of business is located within California.

(2) The total employment of the corporation is no more than 500 employees, as measured by the number of employees covered by federal unemployment insurance on December 31 of the year preceding acquisition of the small business stock, a majority of which employees were covered by California unemployment insurance on December 31 of the year preceding acquisition of the small business stock. However, if more than 50 percent of the outstanding equity securities of all classes are held by another corporation, the employment of the controlling corporation shall be counted as employment of the eligible corporation for purposes of this section.

(3) The outstanding issues of the corporations, including those held by the taxpayer, are not listed on the New York Stock Exchange, the American Stock Exchange, or the National Association of Securities Dealers Automated Quotation system.

(4) No more than 25 percent of gross receipts in the immediate prior income year were obtained from rents, interest, dividends, or sales of assets.

(5) The corporation is not engaged primarily in the business of holding land.

(6) Notwithstanding paragraph (4), 'small business stock' includes an equity security issued by a corporation which has derived no more than 25 percent of its gross receipts from rents, dividends, or sales of assets during any of the first four income years following the date of its incorporation.

Paragraph (6) shall not be deemed satisfied by a corporation which issues equity securities if that corporation, for tax purposes only, liquidates its assets, in whole or in part, in anticipation of qualifying under those provisions and then subsequently reorganizes that portion of the corporation under a new name.

(f) For purposes of this section, 'small business stock' does not include an equity security issued by a corporation which has either of the following characteristics in the income year immediately prior to the taxpayer's sale or exchange of the equity security:

(1) More than 25 percent of its gross receipts were obtained from rents, interest, dividends, or sales of assets.

(2) The corporation was primarily engaged in the business of holding land.

constitutes a new matter in these appeals. Because respondent's original deficiencies are not altered if appellants' stock was not small business stock, the focus of our inquiry is on whether evidence required to prove that appellants' stock was or was not small business stock for purposes of subdivisions (e) or (f) of former section 18162.5 is different from the evidence required to resolve the issue raised by respondent in its original determination.

As the Hagen issue that respondent raised in its original determination is purely a legal issue that does not require the presentation of any evidence for its resolution, it is readily apparent that different evidence is required to resolve the issue of the small business stock status of appellants' stock. Therefore, we must conclude that the issue of the small business stock status of appellants' stock constitutes a new matter in these appeals and, as a result, that the burden of proof with regard to this status has shifted to respondent. Because respondent has provided either no evidence or insufficient evidence to prove that the respective appellants' stock was not small business stock at the pertinent times, we must further conclude that respondent has not carried its burden of proof with regard to the new matter. In view of the foregoing, we find that appellants should be permitted to exclude from preference income the unrecognized portion of their capital gains from the sale of their small business stock.

Accordingly, respondent's action must be reversed.

Appeals of George and Linda Barry, DeWitt W. and
Patricia A. Clinton, Richard and Diana Hirsh, and
Robert K. Levin

-5-

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding,
and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of George and Linda Barry, DeWitt W. and Patricia A. Clinton, Richard and Diana Hirsh, and Robert K. Levin against proposed assessments of additional personal income tax in the amounts of \$16,547.22, \$18,488.53, \$177,486.60, and \$178,997.69, respectively, for the year 1986 be and the same is hereby reversed.

Done at Sacramento, California, this 22nd day of April, 1993, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Fong, Mr. Dronenburg, and Ms. Scott present.

Brad Sherman _____, Chairman

Matthew K. Fong _____, Member

Ernest J. Dronenburg, Jr. _____, Member

Windie Scott* _____, Member

_____, Member

*For Gray Davis, per Government Code section 7.9

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